

PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298



November 2, 2004

Agenda ID #4014

Alternate Agenda ID #4016

TO: PARTIES OF RECORD IN APPLICATION 04-01-031

Enclosed are the proposed decision of Administrative Law Judge (ALJ) Walker and Alternate proposed decision of Commissioner Lynch. These items will not appear on the Commission's agenda for at least 30 days after the date it is mailed. This matter was categorized as ratesetting and is subject to Pub. Util. Code § 1701.3(c). Pursuant to Resolution ALJ-180 a Ratesetting Deliberative Meeting to consider this matter may be held upon the request of any Commissioner. If that occurs, the Commission will prepare and mail an agenda for the Ratesetting Deliberative Meeting 10 days before hand. When an RDM is held, there is a related ex parte communications prohibition period.

The Commission may act at the regular meeting, or it may postpone action until later. If action is postponed, the Commission will announce whether and when there will be a further prohibition on communications.

When the Commission acts on the proposed decisions, it may adopt all or part of it as written, amend or modify it, or set it aside and prepare its own decision. Only when the Commission acts does the decision become binding on the parties.

Parties to the proceeding may file comments on the proposed decisions as provided in Article 19 of the Commission's "Rules of Practice and Procedure." These rules are accessible on the Commission's website at <http://www.cpuc.ca.gov>. Pursuant to Rule 77.3 opening comments shall not exceed 15 pages. Finally, comments must be served separately on the ALJ and the assigned Commissioner, and for that purpose I suggest hand delivery, overnight mail, or other expeditious method of service.

/s/ ANGELA K. MINKIN

Angela K. Minkin, Chief
Administrative Law Judge

ANG:jva

183258

Decision **PROPOSED DECISION OF ALJ WALKER** (Mailed 11/2/2004)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Southern California Edison
Company (U 338-E) for Authority to, Among
Other Things, Increase Its Authorized Revenues
for Gas Service for Santa Catalina Island in 2005,
and to Reflect That Increase in Rates.

Application 04-01-031
(Filed January 23, 2004)

David R. Garcia, Attorney at Law, for Southern
California Edison Company, applicant.
James E. Scarff, Attorney at Law, for the
Commission's Office of Ratepayer, protestant.

OPINION RESOLVING GENERAL RATE CASE

TABLE OF CONTENTS

TITLE	PAGE
1. Summary.....	2
2. Background and Procedural History.....	2
3. Jurisdictional Question	5
4. SCE's Application.....	5
5. Capital Expenses.....	8
5.1 PG Vaporization Plant Upgrade.....	8
5.2 Basement Upgrade	9
5.3 Bird Park Line Extension.....	10
5.4 Pebble Beach Village Line Replacement	10
6. Operations and Maintenance.....	11
6.1 Additional Employee.....	12
6.2 Additional Training.....	13
6.3 Preventative Maintenance.....	14
6.4 Work Management System.....	14
6.5 Uncontested SCE Proposals	16
7. Forecast of Gas Sales	16
7.1 Gas Sales Adjustment Mechanism.....	17
8. Depreciation Expense and Reserve.....	18
9. Rate Base	18
10. Attrition.....	19
11. Rate Phase – In	21
12. Rate Design.....	24
12.1 Baseline Quantities of Gas.....	24
12.2 Allocation of Rates.....	25
12.3 Domestic CARE Rates.....	25
13. Comments on Proposed Decision	25
14. Assignment of Proceeding.....	26
Findings of Fact.....	26
Conclusions of Law	26
ORDER	28
APPENDIX A	
APPENDIX B	

OPINION RESOLVING GENERAL RATE CASE

1. Summary

Southern California Edison Company (SCE) is authorized to increase its gas distribution base rate revenue requirement in Santa Catalina Island (Catalina) to \$964,000 to be phased in over a three-year period beginning in 2005. This equates to a 33.7% increase in 2005, a 29.1% increase in 2006, and a 20.0% increase in 2007 in authorized gas distribution expenses. SCE had sought an increase in base rate revenue to \$1,157,482 in 2005 (an increase of 169% over the current rate), or \$1,648,000 if phased in over four years (an increase that would total 283% over current base rates by the year 2008). The proposed increases are large because this is the first gas distribution rate increase that SCE has sought in Catalina in 17 years and because SCE is in the process of replacing its 30-year-old gas plant in Catalina.

The new rates authorized today will mean an increase in single-family gas bills, on average, of about 12.6% in 2005, 13.2% in 2006, and 11.5% in 2007. For commercial customers, the increase, on average, will be 17.8% in 2005, 15.6% in 2006, and 10% in 2007.

2. Background and Procedural History

Catalina, located 22 miles from the mainland, is a leading resort for the Los Angeles area. The island is 21 miles long and 8 miles wide, with Avalon the principal town. Tourism is the main industry, and the island attracts tens of thousands of visitors annually.

SCE provides all of the gas, water and electric service in Catalina and has done so since 1962.¹ Previous general rate increases for gas distribution costs were granted in 1980 and 1987.² In the 1980 general rate case, SCE was authorized to establish a Gas Cost Adjustment Clause (GCAC) that permits SCE to pass through to customers its wholesale cost of gas purchased for Catalina. Authorized distribution costs, however, have not changed since the 1987 general rate case.

SCE serves 1,300 commercial and residential gas customers in Avalon (as contrasted with 2,400 electricity customers and 1,900 water customers), delivering gas through 6.5 miles of underground distribution pipes. The gas production facilities are located at the Pebbly Beach Gas Plant in Avalon. Liquefied petroleum gas (LPG) is delivered to Catalina by barge and transported by tanker truck to five storage tanks. The LPG is heated and vaporized to change it from liquid to gas, then mixed with air and inserted into the underground distribution system supplying customers in Avalon and Pebbly Beach Village. Driving much of the increase in SCE's gas costs is the pending \$1.3 million replacement of the 30-year-old gas vaporization plant.

SCE filed this general rate case on January 23, 2004. On February 26, 2004, the Commission's Office of Ratepayer Advocates (ORA) protested the request for increased rates. A Prehearing Conference was conducted on April 9, 2004, and Assigned Commissioner Loretta M. Lynch issued a Scoping Memo on April 21, 2004, in which she concluded that a hearing was required.

¹ Decision (D.) 64420 authorized SCE to purchase all of the gas, water and electric service facilities in Catalina.

² See D.92059 and D.87-07-019.

Two public participation hearings attended by about 40 persons were conducted in Avalon on June 7, 2004. The Commission heard from 14 ratepayers, including Avalon Mayor Ralph Morrow and City Councilman Dan O'Connor. Most of the speakers were owners of restaurants and other small businesses in Avalon. While high in their praise for SCE's utility service on the island, they objected to a substantial increase in gas rates that will have to be borne by only 1,335 ratepayers.³ One speaker, Cliff Keene, said that the estimated 74% increase in gas bills resulting from SCE's proposal would be devastating for restaurants because they must use gas to cook and can't raise meal prices by an equivalent amount. Another speaker, Debbie Avellana, described the already high costs of living for many Avalon residents who are service people earning \$7 to \$10 an hour. A number of speakers noted that SCE's electric rates in Avalon are normalized with mainland rates and asked why gas rates could not be similarly normalized. (Both SCE and ORA responded that Catalina is the only location in which SCE provides gas service and there are no mainland gas rates with which the island's rates can be normalized.)

An evidentiary hearing was conducted in Avalon on June 8, 2004. The Commission heard from four witnesses and received the testimony of four other witnesses by stipulation. Final briefs were filed on July 19, 2004, and reply briefs were filed on August 2, 2004, when the case was deemed submitted for Commission decision.

³ Mayor Morrow praised SCE and its Catalina utilities manager Rosemary Rohaley, stating "She's taken over, and she's straightening up our utilities and doing a great job. Except a 74 percent increase in rates is probably where we draw the line. We love you, Rosey, but not that much." (Transcript at 69.)

3. Jurisdictional Question

At hearing, the assigned Administrative Law Judge asked the parties to brief the question of whether this Commission will continue to have jurisdiction over SCE's gas operation in Catalina once SCE replaces its gas vaporization plant. The replacement will convert the operation from blended propane/butane liquefied gas to all-propane gas. The question arises because Pub. Util. Code § 221 defines "gas plant" in a manner that appears to exclude all-propane gas plants from Commission jurisdiction. A discussion of the jurisdictional question is attached to this decision as Appendix B.

The Commission addressed the jurisdictional question in the 1980 general rate case, concluding that since butane at that time was the principal ingredient in the butane/propane mix, the § 221 exclusion would not apply to SCE's Catalina gas operation. All parties agree that at the time of this application and hearing, Commission jurisdiction continued to apply. Our decision today assumes that continued jurisdiction, but we direct our Office of Governmental Affairs to seek clarification of this issue from the Legislature prior to SCE's next Catalina gas general rate case. In that connection, we also direct our General Counsel to consider an appropriate amendment to the Public Utilities Code, if deemed necessary, that we could recommend to the Governor and to the Legislature.

4. SCE's Application

SCE's initial request for an overall rate increase and increases in its authorized expenses are shown on the following table. Also shown are ORA's initial recommendations for the rate increase and operating expenses. The third column shows the adopted increases authorized by this decision.

**Southern California Edison
Catalina Gas Operations
Test Year 2005
Proposed Rates**

	(Thousands of Dollars)		
	SCE	ORA	Adopted
Total Operating Revenues	1,157	888	964
Operating Expenses			
Escalation			
Production	351	249	297
Distribution	215	141	181
Customer Accounts	10	10	10
Uncollectibles	1	0	0
Administrative & General	58	44	44
Franchise Requirements	12	9	7
Revenue Credits	(62)	(62)	(62)
Subtotal	585	391	477
Escalation	60	41	49
Depreciation	128	120	123
Taxes Other Than on Income	60	43	43
Taxes on Income	89	81	50
Total Taxes	149	124	93
Total Operating Expenses	922	676	742
Net Operating Revenue	235	212	222
Rate Base	2,419	2,177	2,276

Rate of Return	9.71%	9.74%	9.75%
----------------	-------	-------	-------

SCE's authorized rate of return is set in annual cost of capital proceedings before the Commission. The 9.75% rate of return was set for 2003 in D.02-11-027. This rate of return was extended through December 31, 2004, when the Commission excused SCE from a 2004 cost of capital application. (D.03-08-063.) SCE's rate of return for 2005 is to be determined in Application 04-05-021, which is pending before the Commission.

In the discussion that follows, we will first address SCE's proposed capital expenditures. When the capital additions are in service, the expenditures are added to rate base, and a rate of return on those expenditures is included in ratepayer bills. We also deal with SCE's proposed operations and maintenance proposals and resolve disputes in that category. Finally, we turn to SCE's proposal for a new gas adjustment mechanism, attrition increases for years after 2005, and a phase-in plan.

5. Capital Expenses

5.1 LPG Vaporization Plant Upgrade

SCE proposes to replace its gas vaporization system and upgrade the fuel supply and storage tank facilities. The estimated total cost of this project is \$1,303,000. The estimated useful life of the vaporization plant is 30 years. SCE's request for a significant increase in the Test Year 2005 revenue requirement is attributable primarily to the vaporization plant upgrade.

The existing LPG system uses a blend of 60% propane and 40% butane, which is delivered to Catalina by barge and transported to Pebbly Beach by tanker truck to four 30,000-gallon propane/butane storage tanks and one 16,000-gallon propane storage tank. The blended LPG is heated and vaporized into a gas-air mixture that ultimately is delivered into the distribution system.

SCE acquired the LPG butane-propane storage and processing system in 1962 and has made many additions and replacements to the system since that time. The company states that the facilities have begun to degrade to the point that reliability is compromised. Inspections have revealed leaks in water bath vaporizers and extensive corrosion. The upgrade includes replacement of water bath vaporizers, mixers, a mix tank, air compressor equipment and an LPG tank. The project will enable SCE to switch from a propane/butane mix to 100% propane, and this is expected to lower costs of gas because propane is available from more sources and is mechanically easier to vaporize.

SCE states that upgrading and relocating the existing LPG processing facilities within the current site is the least-cost alternative in addressing the obsolescence of the equipment and complying with safety requirements. The project is targeted for completion late this year.

ORA in its analysis agrees with SCE that the upgrade is necessary, noting that the existing facility is more than 30 years old and is out of compliance with a number of national fire safety standards. Because the cost will more than double the fixed capital component of SCE's rate base in Catalina, and because rates will reflect a return on that investment, ORA recommends that no rate increase be allowed to go into effect until the project is completed and the new plant is fully operational. SCE has agreed with that position, and our order today so provides.

5.2 Basement Upgrade

The building used by SCE for its electric, water and gas operations has a deteriorating floor that precludes use of heavy equipment because of danger that the floor could collapse into the basement. ORA examined the facility and the concrete integrity evaluation conducted for SCE, and ORA agrees that

upgrading is necessary. Estimated cost of the project is \$400,000, of which 15% or \$60,000 is allocated to the gas operations. Because there has been some delay in completion, ORA recommends that the \$60,000 allocation be effective July 1, 2005 rather than April 1, 2005 as originally requested by SCE. Our order today makes this amount effective on July 1, 2005.

5.3 Bird Park Line Extension

Edison has completed a Bird Park line extension that involved installation of new gas distribution service in conjunction with the City of Avalon for a new city-subsidized low-income building development. The project provided gas service to 24 new customers. ORA reviewed the project, its cost, alternatives considered and vendor selection and recommends approval of the estimated \$95,000 cost of the project. We agree that the record supports this addition to rate base as the least-cost alternative to providing this new service.

5.4 Pebbly Beach Village Line Replacement

SCE proposes to replace 500 feet of gas distribution pipeline to 20 existing residences in Pebbly Beach Village, contending that the line was installed in the 1960s and now has exceeded the 40-year useful life of underground steel pipeline. Cost of the work would be \$265,000, with \$200,000 attributed to SCE's gas operations and \$65,000 attributed to SCE's water utility.

ORA initially opposed this work on grounds that SCE has provided no engineering studies or other evidence that the line, despite its age, is in need of replacement at this time. At hearing, however, SCE presented evidence that it will be sharing the cost of this project with Santa Catalina Island Company, which plans to install a new fire flow line in Pebbly Beach at the same time the gas pipeline is installed. SCE was unable, however, to estimate how much it will save because of the joint project. Mark Bumgardner, ORA's project coordinator,

testified that ORA would support a \$100,000 allocation for the pipeline work if its costs are shared with the fire flow work.

In the absence of any revised estimate of cost because of the participation in the work by the Santa Catalina Island Company, our decision today approves \$100,000 for this gas pipeline replacement.

6. Operations and Maintenance

SCE seeks a 68% increase in what has been budgeted in the past for its operations and maintenance expenses, citing a need for increased maintenance, employee training and compliance with numerous federal and state regulatory reporting requirements. Based on extensive discovery and a site visit, ORA objects to most of these increases. Both parties used a five-year average to estimate expenses, but SCE then sought additional amounts in several accounts to meet what it termed new “regulatory, safety, and reliability requirements.”⁴ ORA contested this, stating:

In many instances, when pressed to identify what was the source of the 2005 budget in data requests, Edison witnesses repeatedly answered that the budgets that were “determined reasonable by SCE management, evolved during a series of discussions between SCE management and line employees” and that Edison did not maintain any “notes or calculations used to develop these forecasts.”

ORA’s investigation also found that in the very recent past Edison had substantially over-estimated its O&M expenses. For example, Edison in its application estimated that its O&M expenses would be \$750,000 in 2003. However, recorded 2003 O&M expenses were only \$456,000. (ORA Opening Brief, at 14; footnotes omitted.)

⁴ SCE rebuttal testimony, Ex. 2 at 2.

What follows are the positions of the parties as to each of the operations and maintenance accounts in dispute and our resolution of those disputes.

6.1 Additional Employee

SCE proposes \$76,000 for a full-time equivalent employee to perform additional maintenance and inspection tasks.⁵ ORA claims that SCE has failed to justify this additional position, and that the new gas plant should obviate the need because of its increased efficiency.

SCE presented evidence showing that the new LPG plant will require an expanded preventative maintenance program to test and inspect the additional safety features in the new plant. SCE also testified that the additional staffing is required for a major pipeline testing and repair program that the company has begun. Hiring of an additional employee, SCE contends, will reduce SCE's reliance on more costly staff overtime to complete inspection and training requirements.

SCE has shown the need for an additional employee to augment its small staff on the island, and this addition should reduce SCE's need for additional overtime costs to accommodate employee training. We grant the requested increase of \$36,000 in FERC Account 844.2 and \$36,000 in FERC Account 874.⁶

⁵ The cost is split at \$36,000 each between FERC Account 844.2 (LPG Processing Terminal Labor and Expenses) and FERC Account 874 (Mains and Service Expense).

⁶ All utilities use a standard system of plant accounts mandated by the Federal Energy Regulatory Commission (FERC), hence the term FERC accounts. However, FERC has no jurisdiction over SCE's gas rates on Catalina. FERC regulates natural gas transmitted in interstate commerce, which does not include SCE's service to Catalina.

6.2 Additional Training

For Test Year 2005, SCE requested a total of \$280,000 in FERC Account 844.2, \$77,000 in Account 874 and \$58,000 in Account 920/921. ORA recommended a disallowance of additional training costs of \$2,000 in Account 844.2, \$2,000 in Account 874 and \$5,000 in Account 920/921 for a total disallowance of \$9,000. ORA also would disallow \$60,000 in additional overtime costs for training purposes (\$30,000 in Account 844.2 and \$30,000 in Account 874).

SCE's witness stated:

Federal regulations require that gas distribution operators and maintenance personnel be able to perform specific tasks to ensure the safe operation of the gas distribution system. To comply with these requirements, SCE is implementing a comprehensive formalized operator qualification training program and developing and maintaining "critical task" operating procedures to support this effort. (SCE Opening Testimony, at 39-40; footnotes omitted.)

ORA argues that all work required by the regulations that govern Catalina's gas distribution operation were in effect during 2002 and were reflected in historical rates. The evidence shows that during 2002, SCE conducted significant training that cost \$83,000, and this amount was included in Catalina's base costs.

We agree with ORA that the record does not support a doubling of training and training overtime costs (\$167,000) from the recorded training costs incurred in 2002 (\$83,000). Our approval of SCE's request for an additional employee at Catalina also serves to reduce added costs in these categories. We adopt ORA's recommended amounts in Account 844.2, Account 874, Account 920/921, Account 844.2 and Account 874.

6.3 Preventative Maintenance

SCE seeks an additional \$22,000 in preventative maintenance expenses in Account 847.1 (LPG Processing Terminal Maintenance Supervision and Engineering). The company testified that the revenue is necessary for inspection and maintenance requirements in the new LPG facility. In response to an ORA data request, however, SCE identified no testing and inspection tasks that are not currently required. ORA urges that a five-year average be used in calculating the 2005 test year cost for this account. We conclude that SCE has not met its burden of showing the need for this increase, and we disallow it.

We will, however, allow a requested \$10,000 increase in Account 847.1 for corrosion protection of pipelines attaching to the new LPG plant. While ORA opposed this increase on grounds that no significant leakage or corrosion has been reported, SCE showed that the pipes in question are more than 40 years old and require additional protection during the plant construction.

6.4 Work Management System

SCE sought an additional \$10,000 for an automated work management system and an additional \$18,000 for a formalized training program, all part of Account 920/921 (Safety Training and Other Non-Operating Expenses). ORA recommends that a five-year average be used in calculating Test Year 2005 costs for this account. ORA testified that SCE's new automated management system would replace one that currently works well and costs less. On cross-examination at hearing, ORA showed that an internal audit report by SCE had only one recommendation for new training (handling of compressed gas), and that was to be completed by July 2002. We find that SCE has not justified these increased estimates for the small workforce it maintains in Catalina. We adopt ORA's recommendations for this account. Of course, this does not

preclude SCE from developing a new automated work management system if it believes such a system will improve efficiency.

6.5 Uncontested SCE Proposals

SCE has applied to the Commission for an exemption from General Order 58A to implement a statistical meter-testing program. ORA supports this on grounds that the program probably will save ratepayers money. We adopt Edison's estimate for Account 878/879 (Meter & House Regulator & Customer Installation Expense).

SCE seeks an expense increase in Account 887 (Maintenance of Mains) of \$65,000 for a major new pipeline testing and repair program. The evidence shows that the rate of underground leaks on SCE's system in 2003 was dangerously high – nearly 1.5 leaks per mile, or 6 leaks on 4.5 miles of steel pipe. ORA testified that the leaks were distributed throughout the system and were not isolated to any one section of pipe, and that it is prudent to begin a thorough testing of the system.

ORA also supports as reasonable SCE's forecast expenses for Account 893 (Maintenance of Meters and House Regulators Expense) and Account 902 (Meter Reading Expense). Testimony at hearing showed the likelihood of the forecast expenses. We adopt these forecasts.

7. Forecast of Gas Sales

ORA forecast gas sales for 2004 through 2008 based on average weather conditions, expected customer growth, economic conditions and phase-in price levels. SCE forecast very small growth in the number of residential customers and no growth in the number of business customers. Given the limited amount of development occurring in Avalon, ORA concluded that SCE's forecasts of customer growth were reasonable. We adopt SCE's customer growth estimates.

The parties differed, however, on their forecasts of gas sales per customer. While both used similar statistical and mathematical models to forecast gas sales,

SCE assumed that the rate increase it seeks will cause reduced gas usage. ORA's analyst presented a regression analysis of recorded gas usage that found no significant relationship between rates and usage for residential customers and only a minor effect for business customers. While the forecasts of both parties reflect a decline in sales for 2005, ORA forecast a somewhat smaller decline. ORA's analysis was based on the methodology that SCE used for projecting gas sales in its 1986 gas case. We will adopt the ORA analysis of gas sales, in part because the rate increase we authorize today is smaller than that sought by SCE and presumably will not result in decreased usage to the extent forecast by the company.

7.1 Gas Sales Adjustment Mechanism

For the first time in its rebuttal testimony, Edison proposed that the discrepancy in forecast sales between ORA and Edison could be handled through the creation of a balancing account. Called the Gas Revenue Adjustment Mechanism (GRAM), the balancing account would be used to calculate the difference each month between authorized gas base rate revenues and actual gas base rate revenues. If the monthly measure showed an over-collection, the amount would be credited to the GRAM; if it showed an under-collection, the amount would be debited. Rates would be adjusted annually to reflect the GRAM balance, including interest.

Like ORA, we question whether the cost and administrative burden of monitoring and reviewing this balancing account is worth the small amounts of money that would be involved. The difference in SCE and ORA sales forecasts for 2005 is relatively small. The proposed balancing account was presented late in the game and has not been subjected to extensive analysis of costs and benefits. We decline to adopt a GRAM balancing account at this time.

8. Depreciation Expense and Reserve

ORA reviewed and considers reasonable SCE's method of calculating depreciation rates, net salvage value, depreciation expense and weighted average depreciation reserve. The differences in the estimates are due primarily to the \$100,000 difference in the capital cost of the Pebbly Beach Village line replacement. In addition, there is a timing difference in the calculation of weighted average balances for plant-in-service. ORA also excludes Construction Work in Progress from rate base on grounds that accounting principles call for this amount to be booked to Allowance for Funds Used During Construction, and these expenses are recovered only after the new plant comes into service. We adopt ORA's estimates, adjusted to recognize \$100,000 for the Pebbly Beach work.

9. Rate Base

The major components of rate base include utility plant, working cash, reserve for depreciation, and deferred income taxes. SCE and ORA agree on the methodology for these calculations. However, ORA's recommended amount for total rate base is some \$244,000 less than SCE's, primarily because of differences in the Pebbly Beach line replacement projections and the exclusion of \$13,000 for Construction Work in Progress. A difference in working cash requirements is due to the differences in Test Year operations and maintenance estimates. We adopt ORA's rate base calculations, adjusted to reflect \$100,000 (instead of \$0) for the Pebbly Beach work.

RATE BASE			
	Edison	ORA	Adopted
FIXED CAPITAL			
Plant-in-service	3,809	3,564	3,664
Construction Work in Progress	13	0	
Total Fixed Capital	3,822	3,564	3,664
Working cash	87	61	61
DEDUCTIONS			
Accumulated Depreciation	(1,082)	(1,079)	(1,079)
Reserve			
Accumulated Deferred Taxes -	(432)	(391)	(391)
Plant			
Accumulated Deferred Taxes - Plant			
Capitalized Interest	25	21	21
RATE BASE	2,420	2,176	2,276

10. Attrition

SCE demonstrated at hearing that it will experience very little growth in gas sales on Catalina. Customer growth is also limited. It follows that SCE cannot rely on increased sales of gas to recover increased operations and maintenance expenses after 2005. SCE therefore seeks attrition increases for the years 2006, 2007 and 2008 of about \$20,000 per year. ORA opposes the request for attrition increases as unnecessary and inappropriate, stating:

Edison can and presumably would come back to the Commission with a new rate case application in three years if it turns out that inflation or other costs increase faster than productivity. If at that time the Commission concludes an increase in the company's rate is justified, the Commission can grant the requested relief then. Given that context, the issue is whether Edison has demonstrated that it will suffer hardship if the Commission does not grant it automatic attrition increases each year for three years. ORA submits that Edison has not demonstrated such hardship. (ORA Opening Brief, at 30.)

SCE argues that the lack of customer growth and the normal effects of inflation make attrition increases necessary. ORA argues that depreciation and retirement of obsolete plant will tend to reduce rate base over the next three years, and the new propane system and pipeline training program are likely to produce lower operations and maintenance costs.

We are not persuaded that burdening 1,300 gas ratepayers with attrition increases is justified, especially since cost increases are not certain to occur. Both SCE and ORA forecast increases in gas sales after a temporary decline next year, and this additional revenue will help offset increases in operating costs. The Commission did not provide for attrition increases in SCE's last general rate case in Catalina. Historically, the Commission has not granted attrition increases to smaller utilities, such as PacificCorp,⁷ Bear Valley Electric⁸ and Mountain Utilities.⁹ In those cases, the utilities were provided balancing accounts for potentially volatile fuel expenses. Similarly here, SCE has a procedure in place for recovering increases in the wholesale cost of propane and passing those costs on to customers. For these reasons, we decline to adopt the proposed attrition increases.

⁷ See D.03-11-019.

⁸ See D.96-05-033.

⁹ See D.99-12-006, Advice Letter 15-E-A.

11. Rate Phase – In

SCE's preferred proposal for an increase in rates is to implement the full Catalina gas revenue requirement in 2005, with no rate phase-in. Recognizing that the Commission would be reluctant to authorize so large an increase in a single year, SCE offered a proposal that would phase in the increase over four years, with a substantial carrying charge for the deferred amounts. If SCE's proposed increases were implemented in 2005, ratepayers would pay rates based on an additional \$727,482 over current base rates. Under its phase-in suggestion, rates would reflect an increase of \$1,218,000, much of it in carrying charges for the deferred increases after 2005.

ORA urges that the authorized increase be phased in over a three-year period to mitigate rate shock and that no carrying charges be assessed against the deferred amounts. ORA notes that even under this proposal, Catalina ratepayers would incur an increase of about 100% over the next three years, and it argues that this is the maximum the local economy can absorb.

SCE comments:

Based on the cumulative losses to SCE over the 2005-2008 period, ORA's rate phase-in proposal can be summarized as "free gas for the summer." ORA's proposals are simply unreasonable. After years of losses on Catalina operations, ORA takes the view that SCE's shareholders should continue to shoulder the burden of even more losses. While it is true that these losses are not large in the context of SCE's entire utility operations, adoption of ORA's proposals contradict cost of service ratemaking principles. (SCE Opening Brief, at 21; footnotes omitted.)

There is logic in SCE's position. If SCE is not permitted to recover its revenue requirement on a forecast basis, then on a forecast basis SCE's investors will not earn their authorized return. If the deferred revenue requirement does

not earn SCE's full cost of capital during the recovery period, then SCE's investors will be receiving a lower return than they could earn on comparable investments. This Commission has long been guided by the principle enunciated by the United States Supreme Court that utility investors must have a reasonable opportunity to earn a return on their investment that is comparable to other investments of similar risk.¹⁰

On the other hand, we are dealing here with substantial costs that can be recovered only from a small group of 1,300 ratepayers. Unlike electricity rates, which have been "normalized" with mainland rates, the gas distribution rates in Catalina stand alone, since SCE operates no other gas services. A slavish application of investor earning principles in this case would work obvious harm on these few Catalina customers while having virtually no effect on SCE shareholders, given the size of the Catalina gas operation relative to the utility's overall operations.

As the Supreme Court said in its seminal *Hope Natural Gas* decision:

We held in *Federal Power Commission v. Natural Gas Pipeline Co.*.... that the Commission was not bound to the use of any single formula or combination of formulae in determining rates. Its rate-making function, moreover, involves the making of "pragmatic adjustments." And when the Commission's order is challenged in the courts, the question is whether that order "viewed in its entirety" meets the requirements of the Act. Under the statutory standard of "just and reasonable" it is the result reached and not the method employed which is controlling. (*Federal Power*

¹⁰ See *Federal Power Commission et al. v. Hope Natural Gas Co.* (1944) 320 U.S. 591, 603; *Duquesne Light Company v. Barasch* (1989) 488 U.S. 299, 307-308.

Commission v. Hope Natural Gas Company (1944) 320 U.S. 591, 602; citations omitted.)

We note that in 1987, the Commission in SCE's last Catalina gas rate case phased in an increase in installments over three years, without a carrying charge.¹¹ As here, the three-year phase-in was deemed necessary to avoid rate shock. SCE has waited 17 years to file this general rate case, apparently undeterred by a low or even negative rate of return during those years.¹² Under these circumstances, we conclude that SCE has not made a persuasive case for attaching carrying charges to the deferred portion of its revenue increase.

At the public participation hearings, customers pointed out that SCE electric rates are normalized with mainland rates, and they asked why some similar arrangement could not be made for gas. The answer is that SCE has no other gas customers who can share in the Catalina costs. Nevertheless, we encourage SCE to consider other approaches that might ease the burden on SCE gas customers, up to and including statutory changes.

12. Rate Design

12.1 Baseline Quantities of Gas

Under Pub. Util. Code § 739(d)(1), the Commission must set baseline quantities of gas for residential customers at an amount between 50% to 60% of average residential use in the summer and 60% to 70% in winter. The current baseline quantities are calculated for Catalina gas customers at 60% summer and 70% winter, consistent with SCE's last general rate case. ORA proposes, and SCE does not object, that the Commission continue to use the existing baseline quantities for the next three years. Our order today so provides.

¹¹ See D.87-07-019.

¹² The record shows that SCE lost money on Catalina gas operations in four of the five years from 1998 through 2002.

12.2 Allocation of Rates

SCE proposes that increased rates be spread equally over the fixed meter charge and volume rates. ORA recommends that the increase be allocated 15% to the fixed portion of the bill and 85% to volume. ORA contends that this allocation will give customers – particularly residential customers – more control over gas charges, since reduced use will result in a reduced bill. In the absence of evidence challenging the reasonableness of this approach, we adopt ORA’s allocation of rates between fixed meter (customer) charge and volumetric rates.

12.3 Domestic CARE Rates

Both SCE and ORA support extension of the California Alternate Rates for Energy (CARE) discounts for Catalina low-income domestic gas service. Under the program, customers qualifying for the CARE program for electric service are enrolled automatically for the proposed CARE schedule for gas service, Schedule G-CARE. Such customers receive a 20% discount in service rates. Approximately 160 Catalina gas customers who participate in the electric CARE program will be eligible for G-CARE. The low-income program reallocates the approximately \$16,000 cost, and there is no impact on overall revenue requirements.

13. Comments on Proposed Decision

The principal hearing officer’s proposed decision was filed with the Commission and served on all parties in accordance with Section 311(d) of the Public Utilities Code and Rule 77.1 of the Rules of Practice and Procedure. Comments were received on _____ and reply comments were received on _____.

14. Assignment of Proceeding

Loretta M. Lynch is the Assigned Commissioner and Glen Walker is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. SCE provides all of the gas, water and electric service in Catalina and has done so since 1962; there are 1,335 commercial and residential gas customers in Avalon.

2. The last general rate case for gas distribution costs occurred in 1987, and SCE has not sought an increase in its authorized distribution costs since that time.

3. Through a Gas Cost Adjustment Clause, SCE is permitted to pass through to customers its wholesale cost of liquefied petroleum gas used in Catalina.

4. In this application, SCE seeks an increase in its gas distribution costs from current base rate revenues in Test Year 2005 of \$430,000 to \$1,157,482 in Test Year 2005.

5. A major factor driving SCE's proposed increase is a \$1.3 million replacement of the 30-year-old gas vaporization system and plant in Avalon.

6. Among SCE's other major capital expenditures affecting gas rates are a basement upgrade in SCE's Avalon building, a new gas distribution line to serve 24 new customers, and replacement of gas pipeline in Pebbly Beach Village.

Conclusions of Law

1. The adopted summaries of earnings and the quantities and calculations that underlie them are reasonable for ratemaking purposes and should be adopted.

2. The Commission should seek clarification from the Legislature as to a jurisdictional question that may arise when SCE's new gas plant switches from mixed liquefied petroleum gas to all-propane gas.
3. No rate increase should go into effect until SCE's new gas vaporization system and upgrade have been completed and the new plant is fully operational.
4. The \$60,000 allocation for a basement upgrade should be effective July 1, 2005, rather than April 1, 2005, as originally requested by SCE.
5. SCE has not met its burden of proof at this time in showing the necessity of a Gas Revenue Adjustment Mechanism balancing account.
6. Attrition increases in operations and maintenance expenses after 2005 have not been justified.
7. Because of the limited number of customers who must bear these costs, ORA's three-year rate phase-in proposal is more reasonable than the four-year phase-in plan proposed by SCE.
8. The rate increase should be allocated 15% to the fixed portion of a customer's bill and 85% to volume so that customers will have more control over their gas costs.
9. Low-income customers should receive a 20% discount in gas service rates under a CARE schedule for gas service.
10. SCE should be authorized to implement the rate changes set forth in this order.
11. This decision should be made effective immediately to allow SCE opportunity to earn the return found reasonable for it in Test Year 2005.

O R D E R**IT IS ORDERED** that:

1. Southern California Edison Company (SCE) is authorized to file in accordance with the General Order 96 series, and make effective on not less than five days' notice, the revised tariff schedules for gas rates for 2005 included as Appendix A to this order. The revised tariff schedules shall apply to service rendered on and after their effective date.

2. Advice letters for authorized rate increases for 2006 and 2007 may be filed in accordance with the General Order 96 series no earlier than November 1 of the preceding year. The filing shall include appropriate work papers. The increase shall be the amount authorized in Appendix A.

3. The summaries of earnings and the quantities and calculations that underlie them, as set forth in this decision, are adopted.

4. The Office of Governmental Affairs is directed to review the jurisdictional question set forth in Appendix B with appropriate members of the Legislature and, in cooperation with the Commission's General Counsel, seek any necessary changes in the Public Utilities Code prior to SCE's next gas general rate case.

5. This proceeding is closed.

This order is effective today.

Dated _____, at San Francisco, California.

APPENDIX A
SANTA CATALINA ISLAND GAS SYSTEM

RATE DESIGN

		2005		2006		2007	
RESIDENTIAL		Baseline	Nonbaseline	Baseline	Nonbaseline	Baseline	Nonbaseline
	BASE	0.38936	0.70611	0.52157	0.85815	0.65131	1.00736
	GCAC	0.84538	0.71395	0.84538	0.71395	0.84538	0.71395
	PUCRF	0.00076	0.00076	0.00076	0.00076	0.00076	0.00076
TOTAL RESIDENTIAL		1.23550	1.42082	1.36771	1.57286	1.49745	1.72207
COMMERCIAL							
	BASE	0.92129		1.17034		1.41569	
	GCAC	0.97266		0.97266		0.97266	
	PUCRF	0.00076		0.00076		0.00076	
TOTAL COMMERCIAL		1.89471		2.14376		2.38911	

MONTHLY SERVICE CHARGE

Meter Size		Proposed Phase - In			
		Present	Y2005	Y2006	Y2007
175	cubic feet per hour meter	4.00	\$5.35	\$6.69	\$8.03
305	cubic feet per hour meter	6.97	\$9.32	\$11.66	\$14.00
400	cubic feet per hour meter	9.14	\$12.22	\$15.29	\$18.35
675	cubic feet per hour meter	15.43	\$20.63	\$25.82	\$30.98
1000	cubic feet per hour meter	22.86	\$30.57	\$38.25	\$45.90
2000	cubic feet per hour meter	45.57	\$60.94	\$76.26	\$91.50
3000	cubic feet per hour meter	68.36	\$91.42	\$114.39	\$137.26
4000	cubic feet per hour meter	91.14	\$121.89	\$152.51	\$183.01
5000	cubic feet per hour meter	113.93	\$152.36	\$190.64	\$228.76

IMPACT ON AVERAGE CUSTOMER BILLS

	2004	Increase	2005	Increase	2006	Increase	2007
Single Family	\$27.42	12.55%	\$30.86	13.22%	\$34.94	11.53%	\$38.97
Multi Family	\$170.09	9.72%	\$186.63	11.33%	\$207.77	10.00%	\$228.54
Commercial	417.67	17.82%	\$492.10	15.62%	\$568.98	9.99%	\$625.80

(END OF APPENDIX A)

APPENDIX B**Page 1 of 8****Will the Commission Continue to Have Jurisdiction Over SCE Catalina Gas Service When SCE Switches From Blended LPG Gas to All-Propane LPG Gas?****1. Summary**

In its gas service to 1,335 customers on Santa Catalina Island (Catalina), Southern California Edison Company (SCE) plans later this year to operate a new liquefied petroleum gas (LPG) plant using all-propane gas instead of the blend of propane and butane that it has used since 1962. In 1980, the Legislature amended Pub. Util. Code § 221 to exclude propane gas plants from those that come under the ratemaking jurisdiction of the Commission. The Commission at that time continued to assert jurisdiction over SCE's Catalina gas service because the service used a mix of 60% butane and 40% propane. SCE has stated that if the Commission's ratemaking jurisdiction ceases with the switch to an all-propane gas plant, SCE intends to implement cost-of-service rates. In its 2004 general rate case, that would have meant that Catalina gas customers would see an increase in rates substantially higher than that authorized by the Commission.

2. Statutory Background

Effective January 1, 1980, the Legislature amended Pub. Util. Code § 221 to add the words "except propane," so that the section now reads:

"Gas plant" includes all real estate, fixtures, and personal property, owned, controlled, operated, or managed in connection with or to facilitate the production, generation, transmission, delivery, underground storage, or furnishing of gas, natural or manufactured, *except propane*, for light, heat, or power. (Emphasis added.)

APPENDIX B**Page 2 of 8**

The definition of “gas plant” is important because the Legislature gives the Commission jurisdiction over rates only of “gas corporations,” as defined in the Code. The definition of “gas corporation” is set forth in Pub. Util. Code § 222, which in pertinent part states:

“Gas corporation” includes every corporation or person owning, controlling, operating, or managing any gas plant for compensation within this state...”

Thus, if SCE’s Catalina gas operation runs entirely on propane, then it would not be a “gas plant” as defined in § 221. If it is not a gas plant within the Code’s definition, then SCE’s gas operation is not a “gas corporation” as defined in § 222. If SCE’s gas operation is not a gas corporation, then it does not fit into the definition of “public utility” as defined in Pub. Util. Code § 216(a), which in pertinent part states:

“Public utility” includes every common carrier, toll bridge corporation, pipeline corporation, gas corporation, electrical corporation, telephone corporation, telegraph corporation, water corporation, sewer system corporation, and heat corporation, where the service is performed for, or the commodity is delivered to, the public or any portion thereof.

3. SCE’s Fuel Mix at Catalina

SCE serves 1,335 commercial and residential gas customers in Catalina, delivering the gas through 6.5 miles of underground distribution pipes. The existing LPG system uses a blend of 60% propane and 40% butane, which is delivered to Catalina by barge and transported to SCE’s Pebbly Beach gas plant by tanker truck.

APPENDIX B**Page 3 of 8**

In SCE's current general rate case, the largest cost component of the proposed rate increase is associated with SCE's replacement of its existing propane/butane vaporization plant with a new 100% propane vaporization plant at a cost of more than \$1.3 million. The Office of Ratepayer Advocates (ORA), noting that the existing plant is more than 30 years old and has serious deterioration issues, supports SCE's decision to replace the plant. In its application for a rate increase, SCE states:

These new [storage] tanks...will allow SCE to convert its operations to an all-propane LPG vaporization process. SCE has decided to eliminate the use of blended LPG and instead use LPG propane. The transition from blended to propane LPG would occur during major upgrades to the vaporization plant scheduled to be completed in 2004. The new vaporization process will be more efficient and easier to maintain. In addition, propane LPG is more readily available than blended LPG. (Testimony of SCE witness Cagnolatti, Ex. 1 at 3.)

4. Commission's 1980 Decision on Catalina Jurisdiction

The Commission addressed the issue of its jurisdiction over SCE's Catalina gas operation in the 1980 gas general rate case. In its decision (D.92059), the Commission stated:

Effective January 1, 1980, Sections 210, 211, and 212 of Title 10 of the Code of Federal Regulations (CFR) were amended by the Economic Regulatory Administration (ERA) of the Department of Energy (DOE). The amendments exempt butane and natural gasoline from ERA's mandatory petroleum allocation and price regulations. Deregulation of propane was specifically not undertaken.

APPENDIX B**Page 4 of 8**

At the time of the amendment of Section 221, it was generally assumed that the exemption of propane would result in the deregulation of nine utilities, including Edison's Catalina Island operations.

Of importance to the Legislature in undertaking this deregulation was the fact that propane was subject to federal regulation. This basis for amending Section 221 is reflected in Section 2 of Chapter 512, quoted above, in which the Legislature has required the Commission to notify it of any substantial changes in federal regulation of propane "including but not limited to, rate deregulation.

....

While the ERA has also determined that a natural gas liquids stream priced without reference to component products would continue to be controlled, this fact alone is insufficient for us to conclude that Edison's predominantly butane gas supply and operations on Catalina Island come within the propane exemption under Section 221....[G]iven the Legislature's limitation on the Section 221 exemption to propane and its reliance on federal regulation in adopting such an exemption, excepting butane from the definition of "gas plant" would seem to be contrary to the language and intent of the section as it is presently written. Because butane, not propane, is the primary component of the gas supplied by Edison to both domestic and commercial customers on Catalina Island, we should assert jurisdiction over Edison's operations and issue a rate decision. (D.92059, 1980 Cal. PUC LEXIS 786, at 4-5.)

ORA comments that there is little legislative history regarding the amendment of Section 221. ORA reasons that the Commission may have felt that the federal government's price regulation of propane (but not butane) was a necessary ingredient to allow state deregulation of propane operations. (It should be noted that the Federal Energy Regulatory Commission (FERC)

APPENDIX B**Page 5 of 8**

has no rate jurisdiction over SCE's gas operations on Catalina. FERC regulates natural gas transmitted in interstate commerce, which does not include SCE's service to Catalina.)

The Commission's regulation of SCE's gas operation does not impose price regulation on the propane itself, only on the delivery of that propane through SCE's underground pipeline system. The wholesale price of the propane is flowed through to ratepayers via a Gas Cost Adjustment Mechanism. Customers also can fill their propane tanks by taking the tanks to SCE's site, and the price SCE charges for that service is not regulated by the Commission (although the revenues are an offset to the revenue requirement).

5. Other Propane Distribution Companies in California

The Catalina gas operation is SCE's only retail gas operation, but it is not the only propane system in California that delivers propane through pipelines to residential and commercial customers. As to those operations, the Commission has consistently disclaimed jurisdiction based on the legislative amendment to Section 221.

Mountain Utilities provides electric and propane service to 500 customers at and near the Kirkwood Ski Resort. Prior to the legislative amendment to Section 221, the Commission regulated the rates for both electricity and gas service provided by Mountain Utilities. Since the amendment, however, the Commission has deemed the "propane bulk plant and distribution system ...unregulated, except for safety purposes." (*In re Mountain Utilities*, D.01-04-031, 2001 Cal. PUC LEXIS 878, at *4.)

APPENDIX B**Page 6 of 8**

Rolling Green Utilities (Rolling Green) operates public utility water and sewer systems as well as a propane gas system that serve about 200 customers in Big Pine, a mountain community about 15 miles from Bishop in Inyo County. In D.83-03-004, the Commission stated that the utility in 1965 had been authorized to provide public utility water and public utility propane gas services, but it added in a footnote:

Buyer's [Rolling Green's] propane gas corporation is no longer under Commission jurisdiction. (See PU code Sections 221 and 222.) (D.83-03-004, 1983 Cal. PUC LEXIS 626.)

In subsequent decisions in 1993 and 1995, the Commission reiterated its view that the Commission does not have jurisdiction over Rolling Green's propane operations. In D.93-06-089, the Commission stated: "In 1979, the definition of gas plant in Public Utilities Code § 221 was amended to exclude systems delivering propane gas service, thus terminating Commission jurisdiction over Rolling Green's propane gas operation." In D.95-02-026, the Commission stated: "Commission jurisdiction over propane gas operations was terminated in 1979 when the definition of gas plant in Public Utilities (PU) Code § 221 was amended to exclude systems delivering propane gas."

APPENDIX B**Page 7 of 8****6. Commission Jurisdiction Over Gas Safety**

ORA asserts that, regardless of the Commission's authority to regulate propane gas rates, the Commission continues to have jurisdiction over safety regulation of propane gas systems. It states:

The statutes that describe the Commission's safety jurisdiction over propane occur in entirely different sections of the Code (Pub. Util. Code §§ 4451, et seq.) These code sections are separate from, and independent of, the Commission's regulation over the price of propane delivered to retail customers. ORA does not see these sections as giving the Commission any additional authority to set prices for propane distributed through a pipeline system. (ORA Opening Brief, at 7.)

7. Policy Considerations

ORA asserts that the jurisdictional question regarding SCE's Catalina gas service raises important policy considerations.

SCE's gas operations on Catalina appear to be closer to an effective monopoly than might be the case for other propane customers. Catalina customers are unlikely to buy tanks of propane rather than accept delivery of gas through SCE's pipelines. Even if they were to do this, Edison at this time is the only retail vendor of tanks or propane refills on the island. ORA comments:

The Commission was established to protect ratepayers from market power abuses associated with monopolies. Here we have a clear monopoly. (ORA Opening Brief, at 8.)

ORA states that another concern is that, if it were concluded that SCE's Catalina gas operation is outside the Commission's jurisdiction, other gas

APPENDIX B**Page 8 of 8**

utilities could be tempted to switch their fuel to propane to avoid the Commission's jurisdiction. ORA cites the case in Pennsylvania of UGI Utilities, which this year was fined \$750,000 by the Pennsylvania Public Utility Commission for switching 100 customers from natural gas to propane. (*Gas Daily*, June 25, 2004.)

Finally, at Catalina, SCE operates electricity, water and gas services, and apportions its rate-based costs for manpower, construction, equipment and general expenses, among those three utility operations. In its 2004 general rate case, for example, SCE allocated the cost of a Pebbly Beach pipeline replacement between its gas operation (\$200,000) and its water operation (\$65,000). If in the future two of these utilities were regulated by this Commission, and one utility was not, the ability to monitor the allocation of costs would be impeded. Indeed, there may be room for a regulatory analysis concluding that when the personnel, equipment and facilities of three utilities are as closely intertwined as they are in Catalina, deregulation of one of the utilities cannot as a practical matter be countenanced.

Because of the unique circumstances of this case, the question of this Commission's continued jurisdiction over SCE's Catalina gas operations is a matter that should be reviewed by the Legislature. Accordingly, the Commission's order in SCE's gas general rate case directs the Office of Governmental Affairs and the Commission's General Counsel to confer with the Legislature and, if necessary, to seek amendment or clarification of the statutes governing the Commission's jurisdiction.

APPENDIX B

Page 9 of 8

(END OF APPENDIX B)